



California Public Employees' Retirement System
Investment Office
P.O. Box 2749
Sacramento, CA 95812-2749
TTY: (916) 795-3240
(916) 795-3400 phone
www.calpers.ca.gov

Agenda Item 5

October 17, 2011

TO: MEMBERS OF THE INVESTMENT POLICY SUBCOMMITTEE

- I. **SUBJECT:** Revision of Absolute Return Strategies Program Policy
- II. **PROGRAM:** Absolute Return Strategies
- III. **RECOMMENDATION:** Recommend to the Investment Committee approval of the revised Absolute Return Strategies Program Policy

IV. ANALYSIS:

The Absolute Return Strategies (formerly "Risk Managed Absolute Return Strategies") Policy is being revised to reflect changes to the program upon its separation from the Global Equity Program. The changes fall into three categories:

- Investment changes, most notably:
 - Modification of the risk target. Historically the limit on targeted risk was a function of domestic equity markets; this has been changed to global equity markets to better reflect the global scope of the ARS Program.
 - Modification of the liquidity target. This target has been tightened to reflect the ARS Program's increased usage in separate accounts over which CalPERS has more control than commingled hedge funds.
 - Concentration limitation. A cap has been introduced that will limit the ARS Program allocation to any single Absolute Return Fund to 10% of Program assets at the time an investment in that fund is made. This is a new addition.
 - Explicit inclusion of the "Three Pillars" concepts of alignment of interests; control of assets; and transparency of risks and exposures as linchpins of CalPERS negotiations for ARS Program investments.
- Administrative changes, most notably a discussion of CalPERS Hedge Fund Partners, LLC. These changes address findings made by the Office of Audit Services and better explain the structuring of ARS Program investments.

- Formatting changes, designed to improve the readability of the Policy and its accessibility to a wide audience of constituents.

Please note, staff intends to limit ARS exposure to 4% of the Total Fund. This limitation will be incorporated into the Asset Allocation Policy.

The following documents are attached for the Investment Policy Subcommittee's review:

- Attachment 1 - Wilshire Associates opinion letter
- Attachment 2 - Revised Absolute Return Strategies Policy and Glossary

V. RISKS:

Adopting the proposed changes to the Policy may result in the reduction of risks, for example by tightening certain risk parameters (fund concentration, liquidity), while enabling the ARS Program to retain its flexibility. There may be a slight reduction in the opportunity set available to the ARS Program, but some of the opportunities forgone by ARS (e.g., less liquid strategies) are likely already in the domain of other investment units such as Alternative Investment Management. Therefore, the net opportunity-set loss to CalPERS as a whole is expected to be zero.

VI. STRATEGIC PLAN:

This item will further the following goals of CalPERS Strategic Plan:

Goal I: Exercise global leadership to ensure the sustainability of CalPERS pension and health benefit systems.

Goal VIII: Manage the risks and volatility of assets and liabilities to ensure sufficient funds are available, first to pay benefits and, second to minimize and stabilize contributions.

Goal IX: Achieve long-term, sustainable, risk adjusted returns.

VII. RESULTS/COSTS:

The results of this item will provide CalPERS with the enhanced efficiencies and ability to manage the overall portfolio. This policy will provide a foundation for compliance, accountability, and transparency.

CRAIG DANDURAND
Portfolio Manager
Absolute Return Strategies

JANINE GUILLOT
Chief Operating Investment Officer

JOSEPH A. DEAR
Chief Investment Officer